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**BEFORE THE  
FEDERAL COMMUNICATIONS COMMISSION  
WASHINGTON, D.C. 20554**

In the Matter of

Access Charge Reform

Price Cap Performance Review  
for Local Exchange Carriers

Tariffs Implementing  
Access Charge Reform

CC Docket No. 96-262

CC Docket No. 94-1

RM-9210

**ADDITIONAL COMMENTS  
of the  
GENERAL SERVICES ADMINISTRATION**

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October 26, 1998

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## **Summary**

High and increasing rates-of-return for the great majority of LECs under price cap regulation show that these carriers as a group have enjoyed productivity gains far greater than anticipated when the Commission established the X-Factor at 6.5 percent. GSA urges the Commission to increase the size of the X-Factor for use by these carriers in their next annual filings.

GSA explains that the excessive interstate rates-of-return are a direct result of access charges that are far above the underlying costs. These high access charges have caused end users to pay too much for interexchange services and have created unnecessary barriers to open competition for local services. With a greater X-Factor, carriers will be required to reduce their access charges, which will increase the opportunities for more competition, and provide direct benefits for end users.

In these Comments, GSA also urges the Commission to reject requests by two LECs for additional pricing flexibility. These requests are premature because incumbent LECs still have significant control over access to the switched networks as well as the entire local telecommunications infrastructure.

Moreover, although GSA urges the Commission to adopt most of the requests for access charge reform in MCI's Emergency Petition, incumbent LECs should not be authorized to collect PICCs from end users. The PICCs should be levied on interexchange carriers, because they employ the facilities of local carriers to originate and terminate interstate messages and dedicated private lines.

Finally, MCI's Petition demonstrates the need to eliminate unjustified disparities in charges for different types of access facilities. Distinctions between access charges for business and residence subscribers are antithetical to open competition and also difficult to administer efficiently and equitably.

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**ADDITIONAL COMMENTS  
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GENERAL SERVICES ADMINISTRATION**

The General Services Administration ("GSA") submits these Comments on behalf of the customer interests of all Federal Executive Agencies ("FEAs") in response to the Commission's Public Notice ("Notice") released on October 5, 1998. The Notice invites comments and replies to update the Commission on issues concerning access charge reform and the recent performance of the incumbent local exchange carriers ("LECs") under price cap regulation.

**I. INTRODUCTION**

Pursuant to Section 201(a)(4) of the Federal Property and Administrative Services Act of 1949, as amended, 40 U.S.C. 481(a)(4), GSA is vested with the responsibility to represent the customer interests of the FEAs before Federal and state regulatory agencies. The FEAs require a wide array of interexchange and local telecommunications services throughout the nation. From their perspective as end

users, the FEAs have consistently supported the Commission's efforts to bring the benefits of competitive markets to consumers of all telecommunications services.

In the *Access Charge Reform Order*<sup>1</sup> and the *Price Cap Fourth Report and Order*<sup>2</sup> of May 1997, the Commission adopted a market-based approach to access reform and a permanent price cap plan with an X-Factor of 6.5 percent. Carriers and end users have been able to observe changes in the level of competition in the marketplace over a period of more than one year since these two orders were released. Consequently, the Notice invites parties to update and refresh the record in these proceedings to reflect the current state of competition for all telecommunications services. Specifically, the NPRM invites comments and replies on three topics:

- the need to modify the productivity adjustment, or "X-Factor," in the Commission's price cap formula;
- the potential value of proposals for pricing flexibility contained in letters by Bell Atlantic and Ameritech to the Secretary of the Commission; and
- the possible need to modify the Commission's access reform policies as described in a petition to the Commission by MCI.<sup>3</sup>

GSA will address each of these issues in these Additional Comments.

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<sup>1</sup> Access Charge Reform, CC Docket No. 96-262 *et al.*, First Report and Order, 12 FCC Rcd 15982 (1997) ("Access Charge Reform Order").

<sup>2</sup> Price Cap Performance Review for Local Exchange Carriers, Access Charge Reform, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd 16642 (1997) ("Price Cap Fourth Report and Order.")

<sup>3</sup> MCI Telecommunications Corporation, Emergency Petition for Prescription, CC Docket No. 97-250, CCB/CPD No. 98-12, February 12, 1998.

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**II. HIGH EARNINGS BY PRICE CAP CARRIERS DEMONSTRATE THAT A SIGNIFICANT INCREASE IN THE X-FACTOR IS NOW JUSTIFIED.**

**A. The Commission established the productivity offset to meet an objective rate-of-return for LECs under price cap regulation.**

The interstate services provided by all of the former Bell operating companies, as well as the GTE and Sprint companies and eight other carriers, are under price cap regulation. For carriers under this regulation, the weighted average of the prices for all services in a basket must be less than or equal to the price cap index ("PCI"). Each year, the index is set to equal an inflation measure (the Gross Domestic Product Price Index), minus the productivity offset ("X-Factor"), plus or minus allowed exogenous cost changes.<sup>4</sup>

The X-Factor is included in the price cap formula to recognize two variables — (1) changes in the total factor productivity for LECs; and (2) changes in the prices that LECs pay for the resources they require to provide interstate telecommunications services.<sup>5</sup> Both variables are referenced to the overall average for the total domestic economy. Thus, if the increase in productivity (and reduction in input price levels) is expected to be six percent greater for interstate telecommunications services than for the overall domestic economy, the X-Factor should be set at 6.0 percent, plus any consumer productivity dividend ("CPD") that the Commission believes is appropriate.

In 1997, the Commission found that the most reasonable estimate of the productivity differential was six percent, when it established an X-Factor of 6.5 percent

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<sup>4</sup> Price Cap Fourth Report and Order, para. 16.

<sup>5</sup> *Id.*, para. 29.

for the price cap carriers under its jurisdiction.<sup>6</sup> The Commission set the X-Factor at 6.5 percent in order to reflect a 0.5 percent "consumer productivity dividend" as an additional incentive for the LECs to increase their efficiency in providing interstate services.<sup>7</sup>

According to the analysis adopted by the Commission in 1997, a LEC achieving this target productivity improvement would have a rate-of-return equal to the industry average, which the Commission recognized as 11.25 percent when the Price Cap Order was released.<sup>8</sup> This benchmark now provides a convenient gauge for assessing the productivity improvements most recently experienced by the LECs.<sup>9</sup> That is, if the reported rates-of-return for LECs are well above 11.25 percent, most of the carriers have been able to achieve productivity improvements far greater than six percent. On the other hand, if most of the reported rates-of-return are significantly below 11.25 percent, the actual productivity changes have fallen far short of the target.

**B. High rates-of-return show that LECs have achieved major increases in productivity.**

Comparison of the LEC interstate rates-of-return with the 11.25 percent benchmark demonstrates that a greater productivity offset is justified at the present time. According to a report released by the Commission's Industry Analysis Division in July 1998, the interstate rates-of-return for the Bell holding companies ranged from

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<sup>6</sup> *Id.*, para. 18.

<sup>7</sup> *Id.*

<sup>8</sup> *Id.*, para. 17.

<sup>9</sup> The 11.25 percent objective rate-of-return may be reduced in the relatively near future. On October 5, 1998, the Commission released an NPRM requesting comments on the appropriate rate-of-return for the 1,300 carriers subject to this form of regulation, and the low-end formula adjustment for price cap carriers.

10.3 percent to 18.2 percent in 1997.<sup>10</sup> The rates-of-return reported by the Bell companies for that year were:

Ameritech	18.22 %
BellSouth	17.90 %
Bell Atlantic	14.77 %
NYNEX	13.73 %
SBC Communications	
Southwestern Bell Telephone Co.	10.32 %
Nevada Bell	19.46 %
Pacific Bell	11.90 %
U S WEST	15.39 %

Other interstate carriers under price cap regulation also reported very high rates-of-return. For example, of the 46 GTE companies, 41 acknowledged rates-of-return greater than 11.25 percent in 1997. Of 13 Sprint companies, none reported a rate-of-return less than 11.25 percent. In fact, the least profitable Sprint unit reported a rate-of-return of 13.17 percent, nearly two hundred basis points above the threshold. Moreover, of the eight additional price cap carriers reporting to the Commission,<sup>11</sup> only two claimed rates-of-return less than 11.25 percent.

In spite of this pervasive pattern of high earnings, the trend is for earnings to increase. Among the Bell companies, only one experienced a decrease in its rate-of-return from 1991 through 1997, and that decrease was less than one-half a

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<sup>10</sup> Industry Analysis Division, *Trends in Telephone Service*, July 1998 ("Trends Report"), Table 14.1.

<sup>11</sup> Alliant Communications Co., Cincinnati Bell Telephone Co., two Citizens Telecommunications Companies, three Frontier Telephone Companies, and the Southern New England Telephone Co.



percentage point.<sup>12</sup> Moreover, the mean rate-of-return for all price cap carriers jumped nearly four basis points from 11.78 percent in 1991 to 15.64 percent in 1997.<sup>13</sup> In the last year alone, this weighted average increased nearly half a percentage point from 15.15 percent to 15.64 percent.

In sum, a comparison of the actual rates-of-return experienced by price cap carriers with the 11.25 percent standard demonstrates that the existing 6.5 percent X-Factor does not reflect the productivity gains that interstate carriers are now actually experiencing. The Commission should increase the X-Factor, forcing LECs to reduce their rates and charges for interstate services to other carriers in their next annual filings.

**C. Reductions in access charges required by a greater X-Factor will foster open competition and also benefit end users.**

Almost all of the interstate revenues of LECs are derived from access charges on interexchange messages and the end links for interexchange dedicated private lines. Consequently, the excessive interstate earnings of the LECs are associated with access charge structures that do not reflect the underlying access costs.

Excessive access charges have caused end users to pay too much for interexchange telecommunications services. Moreover, access charges that do not reflect costs are one of the most significant barriers to the development of more competition for telecommunications services in the nation. As GSA explained in its comments in CC Docket No. 98-146, high access charges impede open competition

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<sup>12</sup> The rate of return for Southwestern Bell Telephone Co. declined from 10.75 percent in 1991 to 10.32 percent in 1997.

<sup>13</sup> Trends Report, Table 14.1.

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by placing unnecessary financial burdens on potential competitors.<sup>14</sup> Furthermore, excessive access charges can result in the formation of a pool of resources that incumbent LECs can employ to support aggressive attempts to forestall potential competitors from deploying their own services.<sup>15</sup>

Because high access charges are anti-competitive and harmful to end users, GSA urges the Commission to ensure that these charges are reduced substantially when the carriers make their next annual filings. The most direct step to ensure that these reductions are achieved is to increase the productivity offset for price cap carriers.

### **III. THE COMMISSION SHOULD REJECT REQUESTS BY BELL ATLANTIC AND AMERITECH FOR ADDITIONAL PRICING FLEXIBILITY.**

#### **A. Incumbent LECs are prematurely seeking deregulation of interstate telecommunications services.**

In *ex parte* presentations to the Commission, incumbent LECs have attempted to gain increased pricing flexibility and other regulatory changes. These carriers assert that competition is continuing to increase, so that the Commission must extend its commitment to a market-based approach for interstate services.

In its presentation, Bell Atlantic asserted that a "pricing flexibility framework should be adopted immediately as an industry-wide standard."<sup>16</sup> Furthermore, this

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<sup>14</sup> Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans, CC Docket No. 98-146, Reply Comments of GSA, October 8, 1998, pp. 10-11.

<sup>15</sup> *Id.*

<sup>16</sup> Letter from Kenneth Rust, Director, Federal Regulatory Affairs, Bell Atlantic, to Magalie Roman Salas, Secretary, Federal Communications Commission, April 27, 1998.

carrier urged the Commission to reduce the X-Factor in the price cap formula as competition increases, and "to provide a clear path" for removal of all price regulation.

Ameritech made similar claims in its *ex parte* meeting.<sup>17</sup> This carrier asserted that the Commission should "reject efforts calling for a prescription of access rates to forward-looking cost levels." Ameritech also proposed a time-phased approach with milestones for pricing flexibility. For example, Ameritech contends that when competitors have the "ability" to offer services to 25 percent of the markets for transport services, the X-Factor should be eliminated from the price cap calculations for certain LATAs.

GSA urges the Commission to reject these requests that the Commission virtually abandon regulatory control over the interstate services provided by the major incumbent LECs. The "ability" of competitors to offer services is a very nebulous concept that may be far removed from any semblance of a clear position in the market. End users and competitive carriers still depend on the Commission's surveillance over interstate services, because the incumbent LECs still dominate in providing the facilities necessary to access the interstate switched network.

**B. The Commission should not relinquish control of prices, because incumbent LECs still have overwhelming market power over access to the switched network.**

In addition to showing that the X-Factor should be reduced, the high rates-of-return for incumbent LECs demonstrates that these carriers still have enormous market power. Indeed, in almost all cases, incumbent wireline LECs are the only firms that can provide the access facilities needed to originate and terminate interexchange messages.

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<sup>17</sup> Letter from Anthony M. Alessi, Director, Federal Relations, Ameritech, to Magalie Roman Salas, Secretary, Federal Communications Commission, June 5, 1998.

A recent report by the Commission's Industry Analysis Division documents the market share of incumbent LECs.<sup>18</sup> In 1997, the incumbent wireline local exchange carriers had local revenues of \$94.3 billion, which was more than 97 percent of the \$96.8 billion local service revenue total for all wireline local service providers.<sup>19</sup> Moreover, of the \$2.5 billion difference, pay telephone providers accounted for \$600 million, so that the revenues for all competitive LECs in the aggregate were less than two billion dollars.<sup>20</sup>

In addition, parties responding to a recent Notice of Inquiry ("NOI") by the Commission demonstrate that incumbent LECs even exert control over the broadband networks for providing information services to the public.<sup>21</sup> Responses to the NOI show that almost all consumers can obtain wideband information services offered over high-speed, long-haul data networks, including the Internet, but only by employing the wireline access facilities controlled by the incumbent LECs. For example, AT&T reported that there are only about 300,000 cable modem subscribers in all of North America.<sup>22</sup>

With limited deployment of cable modems, wireless facilities, and satellite data services at present time, there is little question that ownership of almost all "last mile" voice transmission facilities also gives incumbent LECs control over access to advanced telecommunications services throughout the country. It is very important to

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<sup>18</sup> Industry Analysis Division, *Telecommunications Industry Revenue: 1997*, October 1998, Table 4.

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*

<sup>21</sup> Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans, CC Docket No. 98-146, NOI released August 7, 1998.

<sup>22</sup> Comments of AT&T in response to NOI, September 14, 1998, p. 13.

consider this fact in evaluating claims by incumbent LECs that they have little influence in modern telecommunications markets.

Moreover, the power of the major incumbent LECs extends far beyond the levels measured by percentage shares of access lines. The major incumbent LECs control almost all of the local telecommunications infrastructure in the nation. To provide services to their own end users, competitive LECs need computer-based access to all operations support systems ("OSS") functions, including pre-ordering, ordering, provisioning, maintenance, repair, and billing for telecommunications services. As GSA has explained to the Commission, comments by competitive LECs in recent proceedings show that they do not yet have efficient access to this infrastructure in most areas.<sup>23</sup> Open competition will be realized only when competitive LECs have efficient access to OSS. Until that time, the Commission should not heed requests by incumbent carriers for relaxed regulation of their interstate services.

#### **IV. THE COMMISSION SHOULD ADOPT MOST OF THE REQUESTS IN MCI'S EMERGENCY PETITION.**

##### **A. MCI recommends changes in the access charge structure that will help consumers and competitors.**

In February 1998, MCI Telecommunications Corp. ("MCI") filed an Emergency Petition ("Petition") for prescription by the Commission concerning access charge reform.<sup>24</sup> In the Petition, MCI urged the Commission to re-visit and modify its access reform policies. MCI stated that action was necessary prior to the LECs' filings on July

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<sup>23</sup> Reply Comments of GSA to the NOI, October 8, 1998, pp. 12-14.

<sup>24</sup> In the Matter of Tariffs Implementing Access Charge Reform, CC Docket No. 97-250, MCI Emergency Petition of for Prescription, February 24, 1998.

1, 1998, or "long distance carriers will continue to be competitively disadvantaged, long distance consumers will be harmed, and competition in local markets will be seriously jeopardized."<sup>25</sup>

The Petition describes two principal requirements for Commission action on an expedited basis. First, MCI stated that the Commission should immediately reduce access charges to forward-looking economic costs. Second, MCI stated that the Commission should require incumbent LECs, rather than interexchange carriers, to collect the Presubscribed Interexchange Carrier Charges ("PICCs") directly from end users until the LECs are providing timely, verifiable, auditable line count information to the IXCs.

In addition, the Petition urged the Commission to:

- greatly clarify, or alternatively eliminate, the distinction between primary and non-primary residence lines for purposes of applying PICCs;
- require LECs to provide interexchange carriers with the information necessary to distinguish between lines for single and multi-line business customers, as well as Centrex lines;
- establish procedures for incumbent LECs to use in accepting information from interchange carriers concerning transferred presubscriptions; and
- take several additional steps to clarify, standardize, and streamline the administrative procedures that incumbent LECs employ to determine which customers' PICCs are assigned to each interexchange carrier.<sup>26</sup>

As described in the Petition, the need for clarification and the potentially extensive changes in the procedures stems from the absence of timely and accurate information,

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<sup>25</sup> Petition, p. 2.

<sup>26</sup> *Id.*, pp. 1-6.

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and widespread confusion in the administrative process. As a result, MCI states, "long distance carriers are placed in the position of having to recover new access costs represented by PICC and Universal Service Fund flow-throughs without the essential data needed to make certain that they are collecting fees in the most accurate way from the customer base."<sup>27</sup>

GSA believes that MCI is correct in calling the Commission's attention to the continuing need for access reform. GSA has strongly urged the Commission to adopt access charges and rate structures that closely reflect the underlying costs as quickly as possible.<sup>28</sup> As GSA has explained, access rate structures that deviate substantially from costs are one of most important barriers to open competition for telecommunications services.<sup>29</sup>

GSA also supports MCI's efforts to obtain clarification, streamline administrative procedures, and promulgate more accurate information on a timely basis. The FEAs are end users of local and long distance services in nearly all exchange areas throughout the nation. From this experience, GSA can attest to the need to clarify the procedures for administering access charge reform and the new universal service initiatives. GSA also can attest to the importance of uniform rules for applying the Commission's access charge and universal service policies to carriers throughout the nation.

However, while the severity of the problem may justify steps to streamline administrative procedures as soon as possible, GSA urges the Commission not to

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<sup>27</sup> *Id.*, p. 15.

<sup>28</sup> Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, CC Docket No. 98-77, Comments of GSA, July 17, 1998, pp. 2-6.

<sup>29</sup> *Id.*

transfer responsibility for collection of the PICC to local exchange carriers. The Commission instituted the PICC as a non-usage sensitive charge to replace recovery of non-traffic sensitive costs through per-minute charges on traffic interchanged between interexchange and local exchange carriers.<sup>30</sup> The PICCs replacing these charges should also be levied on interexchange carriers, and not on end users.

Finally, GSA strongly concurs with MCI that the requirement to provide information differentiating various types of access facilities — including primary residence, non-primary residence, business single lines, business multi-lines, and Centrex lines — necessarily increases the level of difficulty in administering the Commission's policies. Moreover, as GSA has explained, the distinctions in charges among types of service have no economic basis whatsoever.<sup>31</sup> By eliminating the multiplicity of charges and employing a single subscriber line charge ("SCL") and a single PICC for all lines, the Commission would not only simplify the collection process, but also reflect the underlying costs more accurately.

**B. Disparities in charges for business and residence lines complicate recovery of access costs and introduce new cross-subsidies in the rate structures.**

The access charge system adopted for price cap LECs does not recognize the concept of cost causation, and introduces a new set of cross-subsidies in the interstate rate structures. Indeed, there is no cost basis for a difference in monthly access charges for business and residence lines. The SLCs and PICCs are employed to recover non-traffic sensitive costs, so that any differences in traffic levels between

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<sup>30</sup> Access Charge Reform Order, paras. 36-41.

<sup>31</sup> Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation, CC Docket No. 98-77, Comments of GSA, July 17, 1998, pp. 7-13.



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business and residence users does not justify distinctions between monthly access charges.

Moreover, as GSA has explained, the fixed monthly access costs are not greater for business lines than for residence lines.<sup>32</sup> In fact, for all lines provided by a LEC, or the lines provided within any study area, the costs associated with access for multi-line business users will average much less than the access costs for other subscribers because business and government users are usually located in more densely developed areas where local loops to the telephone company central offices are shorter and where there are greater economies of scale in providing local telecommunications services.

The access charges adopted for price cap LECs have disparate impacts on business and residence users. In the initial year, the maximum total SLC and PICC for a primary residential line increased from \$3.50 to \$4.03.<sup>33</sup> In contrast, the maximum total for a multi-line business line increased from \$6.00 to \$11.75.<sup>34</sup> The initial increase of \$5.75 monthly for multi-line business lines is more than 10 times the \$0.53 monthly increase for primary residential lines. The result is a business charge nearly three times that for residence service, with no cost difference at all.

Moreover, in addition to the fact that distinctions between access charges for business and residence subscribers are not justified by costs, antithetical to open competition, and difficult to administer, these distinctions no longer have a practical or administrative basis. The difference between "residence" service and "business"

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<sup>32</sup> *Id.*

<sup>33</sup> Previously a SLC of \$3.50 and no PICC, with no change in the SLC but a PICC of \$0.53.

<sup>34</sup> Previously as SLC of \$6.00 and no PICC, with the SLC increased to \$9.00 and a PICC of \$2.75.

service is becoming arbitrary as more individuals telecommute and employ modems in their homes and offices for both "personal" and "business" use.

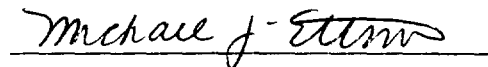
**V. CONCLUSION**

As a major user of telecommunications services, GSA urges the Commission to implement the recommendations set forth in these Additional Comments.

Respectfully submitted,

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October 26, 1998

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I, MICHAEL J. ETTNER, do hereby certify that copies of the foregoing "Comments of the General Services Administration" were served this 26th day of October, 1998, by hand delivery or postage paid to the following parties.

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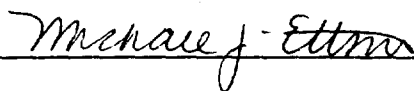
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